Current
Policy No. 202

Oil Supply–Prospects and Policy

July 1, 1980

United States Department of State
Bureau of Public Affairs
Washington, D.C.

Following are statements by Gerald A. Rosen, Acting Deputy Assistant Secretary for International Energy Policy, and Joseph W. Twinam, Deputy Assistant Secretary for Near Eastern and South Asian Affairs, before the Subcommittee on Europe and the Middle East of the House Foreign Affairs Committee on July 1, 1980.

ACTING DEPUTY ASSISTANT SECRETARY ROSEN

Oil-supply prospects and U.S. international energy policy are critical subjects. Even though the oil market has eased over the past few months, the long-term outlook gives cause for serious concern. OPEC nations' oil exports are unlikely to increase beyond today's level, and competition for that oil is likely to increase. The total amount of imported oil available to the industrial democracies is likely to decline significantly over the next decade. Furthermore, these diminishing supplies could be subject to sudden interruptions or price increases.

Superimposed on all of these potential difficulties is a substantially altered structure in the world oil market. Since 1973 the influence of the major oil companies has declined as their share of OPEC exports has gone from over 90% to about 45%. Oil-producing countries now market directly, in channels outside the majors, almost 13 million barrels per day (mm b/d) compared to only 2.4 million barrels in 1973. Some important implications of these developments are:

- During a period of market tightness, prices are bid up as potential buyers, formerly supplied by the majors as third-party customers, compete against each other for oil now sold directly by producers;
- Some crude-short majors also are forced into the spot market;
- Oil sales may become increasingly politicized as government-to-government deals become more common; and
- The industrialized oil consumers are becoming lower priority customers of OPEC as OPEC's own consumption needs and LDC [less developed countries] oil requirements, frequently met through direct government deals, take precedence over OPEC sales to major oil companies.

To attempt to deal effectively and systematically with these and other troublesome aspects of the energy situation, which confront all nations of the world, the Administration has developed three closely interconnected elements of its international energy policy.

- To cooperate with other industrialized democracies to control oil consumption, promote development of alternative energy sources, and prepare a common approach to possible oil supply shortfalls or disruptions.
- To work with the OPEC countries to insure that their oil production and pricing policies take account of the world's need for an adequate supply of oil at reasonable prices.
- Finally, to promote the development of energy sources in developing countries to increase global energy supplies and to ease the energy constraint upon these nations' economic growth.

To be successful, our international energy activities must be based on a

strong domestic energy policy. Other industrial nations look to the United States for leadership in developing effective domestic policies since they recognize that acting alone they can have no decisive effect on global energy balances. The major oil-producing nations have emphasized that our conservation efforts make it easier for them to contribute to stabilizing energy markets through their price and production policies. Developing nations will be more responsive to our international policies if they see that we are making a maximum effort to develop our own energy resources and to use energy wisely.

I would like to concentrate on the following elements of our policy:

- The production and pricing policies of some of the major oil producers outside the Middle East;
- U.S. international energy policy, with particular emphasis on recent accomplishments at the annual economic summit meetings and in the International Energy Agency; and
- The energy recommendations of the Brandt Commission.

Oil-Supply Outlook

Last month in Algiers, the OPEC ministers decided to set a price ceiling for "marker" or benchmark crude at $32 per barrel. They also agreed that surcharges or value differentials of up to $5 per barrel could be added to reflect differences in quality or location. We do not know how this decision will affect other premiums, such as premiums for new buyers, for incremental volumes, or for exploration rights. The Saudis have indicated they may increase oil prices in the next few months, but probably not to the $32 ceiling, at least initially.

According to press reports, the OPEC long-term strategy committee at at its meeting in May recommended that over the long term, prices should approximate the cost of alternative fuels. To insure advancement toward that target, the committee proposed a price floor adjustment mechanism. This mechanism would adjust oil prices to account for inflation, exchange rate changes, and OECD [Organization for Economic Cooperation and Development] real growth rates. To sustain these price changes OPEC countries would adjust production as necessary.

Moreover, as OPEC's own oil consumption grows, with production likely to be essentially steady or declining, OPEC oil available for export will necessarily decline. At the same time, the non-OPEC developing nations and the Communist nations are likely to increase their demand for OPEC oil. This means that developed country access to OPEC oil will be reduced. It is, in our view, crucial that this expected decline in oil availability be matched by a reduction in developed countries' demand brought about by our own efforts to conserve energy and switch to alternatives.

If we are unprepared to cope with reduced oil supplies, the result would be a rapid bidding up of world oil prices which would impose tremendous economic costs on us. Any interruption of these reduced supplies—whether by accident or political design—would impose still more serious costs.

I believe it would be useful to indicate why we believe OPEC's exports are unlikely to increase beyond today's level. The Persian Gulf oil producers are the most important in this regard because these are the countries which have the physical capacity to increase oil production substantially. I will, however, defer to Mr. Twinam for an analysis of the oil policies of the Persian Gulf and North African producers and will instead discuss briefly other important oil producers, their likely output levels, their policies, and our influence.

Other Producers

Oil consumers have begun to look with increased interest toward oil producers in other areas of the world because of recent events in the Middle East. I do not propose to cover in detail all of these producers but would like to provide some information on four groups of countries: major non-Middle East OPEC countries, oil-exporting LDCs, the North Sea producers, and China and the Soviet bloc countries.

Non-Middle East OPEC. The largest producers in this group are Indonesia, Nigeria, and Venezuela. Each has limited resources of conventional oil and faces potential production declines. Since these countries have relatively large developing economies which can make good use of oil revenues as a tool for economic growth, they will probably continue oil production at maximum capacity.

Indonesia has recently increased exploration expenditures, reversing the trend of the past few years. Additional oil will no doubt be found (reserves are now 9.5 billion barrels), but the discovery of large fields is unlikely based on the geology of the country. If there are no major new finds, rapidly increasing domestic demand for oil (12%–15% annually) may result in Indonesia becoming a net oil importer by 1990.

In many ways, Nigeria is similar to Indonesia. Output is static at about 2 mm b/d, while proved and probable reserves are only 20–26 billion barrels. While it is likely that more oil can be found, the Nigerian Government has not emphasized exploration and appears to be focusing on the exploitation of other energy sources. One project being considered is to export some 1,500 million cubic feet per day of liquefied natural gas.

Venezuela is another example of a large oil producer facing declining production. Output has declined from 3.7 mm b/d in 1970 to 2.1 mm b/d projected for 1980. Official reserves are less than Nigeria's, requiring Venezuela to intensify its exploration activities or exploit its nonconventional petroleum if it is to sustain output at current levels.

Venezuela has a major source of nonconventional oil in the Orinoco heavy oil belt. Estimates vary widely, but oil-in-place is probably in the range of 750 billion to 3 trillion barrels. Since the recoverability factor could be anywhere from 10%–25% of oil-in-place, ultimate potential production from these reserves is highly uncertain, ranging from as little as 75 billion barrels to as much as 750 billion barrels (compared to Saudi Arabian reserves of 166 billion). Venezuela has decided on a phased plan for exploration of its heavy oil in order to test out alternative technical processes in commercial-scale pilot projects before deciding what processes to use for subsequent expansion of heavy oil production. The present plan calls for 1 mm b/d output of heavy oil by the year 2000. Limiting factors are Venezuela's sensitivity to including foreign multinationals, which could help with the technology required, and the need for refinery modifications to process the heavy oil.

While the United States has good relations with these countries, our ability to influence their oil production decisions is limited. The primary action we can and have taken is to urge provision of adequate incentives for new exploration.

Oil-Exporting LDCs. The more important of these countries are Mexico, Malaysia, Egypt, and Angola. With the possible exception of Mexico, these countries are likely to continue to produce at full capacity because petroleum revenues are critically important to finance their economic development.

The case of Mexico is somewhat more complicated. Mexican oil production is continuing to grow, and reserves could support a very high level of production. President Lopez Portillo has stated, however, that Mexico will limit its production to domestic needs plus an export level which will provide revenues needed for balanced growth. Mexico is finding that it can absorb a greater quantity of imports than initially anticipated, and if the Mexican Govern-

ment expands social programs, it would imply an increase in petroleum exports beyond projected levels. There are some in the country, however, who argue that production should be restrained, either to manage resources more conservatively or because they fear ambitious development programs would lead to disastrous inflation. In any event, it is unlikely that long-term production decisions will be made in the next 2 years before the 1982 presidential election.

The United States, Mexico's largest customer, is receiving about 590,000 barrels per day (b/d) of current Mexican exports of 820,000 b/d. Because of the economics of transportation, the United States will continue as Mexico's largest customer, but many countries are vying for Mexican oil, and the Mexican Government has indicated a desire to diversify its sales. Nonetheless, even though the U.S. share is declining, Mexico's accelerating production may lead to an increase in the absolute level of exports to the United States.

The North Sea Producers. Based on current estimates of proven reserves, U.K. oil production should peak at about 2.5 mm b/d in 1985. Production is then expected to decline steadily and could reach about 1.0 mm b/d by the early 1990s. This suggests that the United Kingdom could become self-sufficient in oil within the next year and be a net exporter into the late 1980s. These estimates, however, do not take into account future discoveries or development of fields not judged commercial at mid-1979 prices.

Because North Sea crudes are light and sweet, they command top prices along with North African and some Nigerian crudes. Thus far, the United Kingdom has followed prices of comparable OPEC crudes.

There are indications that the U.K. Government is considering restricting depletion rates to stretch out the period of net self-sufficiency. No official announcement has been made, but U.K. Energy Secretary David Howell has publicly indicated that a new policy is being considered, and Labor Party shadow Secretary for Energy David Owen has called for a long-range production policy aimed at self-sufficiency.

Should such a policy evolve, it could mean that the United Kingdom will be producing in the mid-1980s at about 300,000–500,000 b/d less than has been officially projected based on technical consideration. We have urged the United Kingdom to consider allowing production to continue at the maximum efficient rate.

Norway's proven oil and gas reserves as of mid-1979 were estimated at about 11.5 billion barrels of oil equivalent, divided about equally between oil and gas. The Norwegian Government recently reaffirmed its longrun oil and gas production goal of 1.8 mm b/d which could be reached by the mid-1980s. Currently, Norway produces about 600,000 b/d of oil and a slightly smaller amount of gas. Following an export-oriented production policy, Norway exports almost all of its gas as well as 400,000 b/d of oil.

The Norwegian Government is undergoing a comprehensive review of its North Sea production policy in the wake of the recent disaster in which the offshore structure, *Alexander Keilland,* capsized with the loss of 123 lives. Indications are that Norway's longrun oil policies will remain unchanged, but its offshore operations will be more carefully scrutinized. The result is likely to lead to slower exploration, especially north of the 62d parallel, as more stringent safety requirements are imposed on offshore structures and personnel. This northern region, yet unexplored, encompasses 85% of the Norwegian continental shelf, and substantial discoveries could enhance Norway's production possibilities significantly. Although this area appears promising, development will be very costly. Even if commercial discoveries were made, 5–8 years would be required before production could begin.

Norway has not been an oil price leader, but has been quick to follow other producers of sweet, light crudes to post top prices. This has evoked criticism from some of Norway's neighbors.

China and the Soviet Bloc. Substantial uncertainty surrounds the petroleum situation in China. Large-scale exploration is just getting underway, and it will be a few years before we have a reasonably accurate picture of China's potential. Present production is about 2 mm b/d. While China may have as much as 80 billion barrels of recoverable oil, the rate of annual increases in output is declining. Growth in output in 1979 was 1.9%, and China is now turning to Western firms for the sophisticated technology needed for offshore exploration and development.

China looks toward petroleum to finance the import of technology and capital goods needed for modernization. It is difficult, however, to judge how much revenue will be needed to support planned growth rates. In any case, sizable increases in exports are not likely before 1985, when results can be expected from activities recently initiated by foreign firms.

The Soviet Union's energy situation is characterized by declining or stagnant oil production, along with an abundance of oil, gas, and coal resources and nuclear energy capability. Their production problems result mainly from managerial and technological difficulties compounded by reserves being located in extremely hostile environments at long distances from energy consumers.

One problem which complicates our assessment of likely Soviet oil production and policies is lack of hard data on Soviet oil reserve estimates and on projected Soviet oil production. The uncertainties are substantial, but it appears that the Soviet bloc might soon shift to a net importer position from its traditional role as an exporter of oil.

WORLD CRUDE OIL PRODUCTION EXCLUDING NATURAL GAS LIQUIDS
(thousand b/d)

	1978	1979
WORLD	**60,190**	**62,400**
Non-Communist countries	**46,425**	**48,370**
Developed countries	**12,170**	**12,745**
United States	8,700	8,535
Canada	1,315	1,495
United Kingdom	1,080	1,570
Norway	355	405
Other	720	740
Non-OPEC LDCs	**4,455**	**4,915**
Mexico	1,215	1,460
Egypt	485	525
Other	2,755	2,930
OPEC	**29,800**	**30,710**
Algeria	1,160	1,135
Ecuador	200	215
Gabon	210	205
Indonesia	1,635	1,590
Iran	5,240	3,035
Iraq	2,560	3,435
Kuwait[1]	1,895	2,215
Libya	1,985	2,065
Neutral Zone[2]	475	565
Nigeria	1,895	2,305
Qatar	485	505
Saudi Arabia[1]	8,065	9,250
United Arab Emirates	1,830	1,835
Abu Dhabi	*1,445*	*1,465*
Dubai	*365*	*355*
Sharjah	*20*	*15*
Venezuela	2,165	2,355
Communist countries	**13,765**	**14,030**
U.S.S.R.	11,215	11,470
China	2,080	2,120
Other	470	440

[1] Excluding Neutral Zone production, which is shown separately.
[2] Production is shared equally between Saudi Arabia and Kuwait.

Cooperation with Industrial Consumers

Excessive dependence on imported oil clearly threatens the economic health of the industrial nations. In 1979 a relatively small and temporary interruption of supplies caused a more than doubling of oil prices. Today the United States is receiving about a million barrels a day less oil than a year ago, but U.S. payments for imported oil in 1980 are expected to reach $90 billion. This import bill will make it harder to master inflation and overcome the current recession.

These problems are likely to grow more serious over the coming decade as oil supplies tighten further. We recognize that the economic strains of the energy crisis have the potential to weaken the mutually reinforcing economic, political, security, and cultural ties which we have built up since World War II with the democracies of Western Europe, Japan, Canada, Australia, and New Zealand. Many of these nations are more dependent on imported oil than we are. Their vulnerability increases our own vulnerability. We cannot let our energy problems tear down relationships which have taken us years to build. Rather,we are determined to find cooperative solutions to our mutual energy problems and by so doing to turn energy into a force which will unify, not divide us.

Our urgent tasks are to reduce our vulnerability to sudden supply interruption and price increases and to make an orderly transition to a world economy less dependent on oil. We have been making some progress on these issues in the International Energy Agency (IEA) and at the annual economic summit meetings.

Since 1974, the IEA nations have had an emergency oil-sharing system for use in the event of major disruptions. In 1979, however, we learned that even a relatively small shortfall could, under conditions of uncertainty, lead to sharp increases in the world price of oil, with painful effects on our economies. Since the onset of the Iranian crisis, we have developed a flexible system for responding to oil-market disturbances which are not large enough to trigger the IEA emergency sharing system. In March 1979 the IEA nations agreed to reduce their collective demand for oil on the world market by 2 mm b/d. Although reduction did not take place fast enough to cool off a steaming oil market right away, our restraint was helpful in slowing down the pace of oil price increases throughout the first half of this year and in encouraging moderate oil producers to maintain responsible production levels. Without the IEA action, prices would probably have increased even more.

To replace the creative but improvised response to the oil crisis of 1979, the May 1980 IEA meeting at ministerial level established an ongoing system of oil-import yardsticks and ceilings designed to improve our ability to deal with tight oil markets. Under this system, the IEA nations will establish national oil-import "yardsticks" each year. These yardsticks will be based largely on projections of oil requirements. In normal circumstances these yardsticks will be used to monitor each nation's performance in reducing oil imports. If the oil market tightens, the IEA nations will consider converting the yardsticks into politically binding oil-import ceilings. Nations would be expected to use effective energy policy measures to restrain demand for oil to levels compatible with their national ceilings.

The United States and its allies have also made progress toward the longrun goal of reducing imports and thus facilitating the transition of the world economy away from its heavy dependence on oil. At the Tokyo summit last June, we pushed for strong commitments on limiting medium-term oil imports and achieved the following results:

- The United States adopted as a goal 1985 imports not to exceed the 1977 level of 8.5 mm b/d;
- Japan agreed to limit 1985 imports to between 6.3 and 6.9 mm b/d;
- Canada agreed to limit 1985 imports to 0.6 mm b/d or less; and
- France, Germany, Italy, and the United Kingdom agreed to limit 1985 imports to the 1978 figure.

At the December 1979 IEA ministerial meeting, all IEA nations adopted national oil import goals for 1985. At the May 1980 IEA ministerial meeting, IEA nations agreed that it would be necessary to undershoot substantially these 1985 goals. The United States and the IEA Secretariat believe that a reduction of 4 mm b/d for the IEA as a group is both necessary and achievable.

At the May 1980 IEA ministerial, IEA nations for the first time established energy objectives for 1990. They agreed to take action to limit the ratio between energy growth and economic growth to 0.6. (Before the oil crisis the ratio had been about 1.0). They also agreed to reduce the share of total energy requirements supplies by oil from 52% now to 40% by 1990.

These commitments will be strongly reinforced by actions taken at the Venice economic summit meeting. At Venice, the heads of state agreed on specific policy measures that each nation should undertake to insure a substantial reduction in oil use over the decade. They also pledged to make a coordinated and vigorous effort to increase the availability of alternative fuels by the equivalent of 15–20 mm b/d of oil over the next decade. This will require greatly expanded production of coal, nuclear, gas, synthetic fuels, and renewables. The United States intends to do its share. We have made great progress in these areas in recent years; our allies acknowledge and appreciate this. We have reduced our import levels from 8.5 mm b/d in 1977 to less than 7 mm b/d during the first half of this year. Our recent energy policy initiatives will encourage a continuation of this progress in the future.

Several problem areas remain; each nation has room to make some improvement in energy policy. At recent summit and IEA meetings, we have criticized some aspects of the energy policies of our allies; they, in turn, have pointed out areas where they feel we could make improvements. Among the most important areas in which our allies see room for improvement in U.S. policy are gasoline taxes, oil use in electricity generation, and coal exports. Our allies, most of whom impose taxes of $1–$2 per gallon on gasoline, were disappointed by the defeat of the President's gasoline conservation fee. They also attach importance to the Administration proposals to encourage conversion of power plants from oil to coal and to remove obstacles to increased exports of coal.

Our efforts to establish tough objectives and to take steps to achieve them are also valued by oil producers. Many of the Persian Gulf producers are concerned about stretching the productive life of their one significant economic resource and have linked responsible price and production policies to strong efforts in conservation by the industrial nations. The developing nations also support our efforts. They fear that without restraint, our appetite for energy could crowd them out of the world oil market.

Brandt Commission Report

Finally, I would like to take up the ideas on energy proposed in February of this year by the Brandt Commission report, *North-South: A Program for Survival.* In the report, energy is part of the emergency program for the next 5 years together with the problems of resource transfers, food, and reforms of the international economic system. In fact, the emergency program calls for a major

global agreement on these issues, including "an international energy strategy" that would insure "regular supplies of oil, more rigorous conservation, more predictable changes of prices, and more positive measures to develop alternative sources of energy."

The report argues that there is a strong case for an understanding between all producers and consumers, citing the particular impact of sudden rises in petroleum prices on developing countries and the fact that "no country can escape serious disruption if its supplies of oil are drastically reduced." The report calls for an agreement on energy to include: production assurances, special arrangments to insure that poorer developing countries receive adequate supplies of oil, demand restraint commitments, indexed price increases at levels which give incentives for production, guarantees of accessibility and value of financial assets, major investment in energy resource development in developing nations, increased funding for energy research, and broad international access to the fruits of that research.

The United States is interested, in principle, in undertaking constructive discussions between producers and consumers on the future of the oil market. We have made clear our interest in pursuing such talks as recently as the Venice summit, when the summit nations agreed to "welcome a constructive dialogue on energy and related issues between energy producers and consumers in order to improve the coherence of their policies."

Topics mentioned for discussion by industrialized nations or by producing nations include those listed above as well as spare oil production capacity for emergency use and cooperation in industrialization of OPEC countries. Some of these subjects would present formidable legal, political, and economic challenges. In any case, to date, the main producers have declined to enter discussions about oil price and supply and are willing to discuss other aspects of energy only when linked to other development-related international economic issues. Efforts in the United Nations to initiate discussions solely on energy, such as Mexican President Lopez Portillo's proposal last fall, have not been successful, largely because of the opposition of OPEC countries.

A comprehensive producer-consumer agreement, even if achieved, would be difficult to enforce. To hold down prices in the event of an interruption would require a buffer stock or excess capacity. But a buffer stock of adequate size would be extremely expensive and difficult to build and maintain. Excess capacity, though cheaper than holding stocks, is also very expensive to install and maintain. We could offer to help finance excess capacity, but control of this capacity would effectively rest in the hands of producers. Internal political pressure would make it difficult for OPEC nations to use this capacity to hold down prices if a serious interruption drove spot prices up rapidly. And a producer-consumer agreement would not prevent interruptions arising from political instability, such as in Iran. Any agreement on prices could, therefore, turn out to guarantee a floor price but not prevent excessive price increases. Notwithstanding these potential difficulties, we can endorse the idea of producer-consumer negotiations. We are confident that at least some progress can be made.

We are moving rapidly ahead in some areas which the Brandt Commission highlights. The report makes a strong case for major financial and technical assistance for oil and gas development in non-OPEC Third World countries, estimating that additional capital of roughly $14 billion annually is needed in the 1980s for these purposes, including $3.3 billion in official multilateral loans. We are now actively seeking ways to assist in expanding oil and gas production from non-OPEC developing countries. We have made increased assistance for energy development in energy-deficient countries a high priority item in our approach to the upcoming U.N. global negotiations and expect to receive broad support. Furthermore, the Venice summit requested the World Bank to examine the adequacy of the resources and mechanisms now in place for increased conventional and nonconventional energy development in oil-importing developing countries, to investigate ways to improve and expand its lending programs in this area, and to discuss its findings with both industrialized and oil-exporting countries.

The Brandt Commission also stresses industrialized consumer countries' responsibility in energy conservation and calls for "more ambitious targets than those agreed in 1979 at the Tokyo Summit and by the twenty members of the International Energy Agency." We have been moving in this direction. Our recent commitments at the summit and the IEA ministerial indicate that the industrial nations recognize their responsibility and are taking concrete steps to achieve unprecedented reductions in energy consumption within this decade.

Emphasis is also placed on hydroelectric development and on solar energy. We are actively engaged in preparing for the upcoming 1981 U.N. Conference on New and Renewable Sources of Energy which will promote use of both of these resources as well as biomass, wind energy, ocean, geothermal, oil shale and tar sands, peat, and draft animal power.

While the report is clear on the issues of development of oil and gas in developing countries and renewable energy sources, it devotes less attention to coal and nuclear energy. We would emphasize that to the extent that industrialized countries shift to coal and nuclear energy sources, there will be more leeway in international oil markets which would also benefit the oil-importing developing countries. Measures to increase production, trade, and use of coal are receiving high priority both domestically and internationally in the IEA and at recent economic summit meetings.

The Brandt report proposes the establishment of a global energy research center under U.N. auspices to coordinate information and projections and to support research on new energy resources. It is certainly to everyone's advantage to increase international cooperation on energy research. Useful mechanisms for that cooperation exist now in the IEA and in other bilateral and multilateral agreements, and we shall give serious attention to other possible means to encourage research which are broadly supported within the international community.

AMBASSADOR TWINAM

I welcome the opportunity to appear before this subcommittee to discuss an issue of profound importance to U.S. strategic and economic interests—the oil policies of the members of the Organization of Petroleum Exporting Countries (OPEC) in the Middle East and North Africa and U.S. policies for dealing with our interest in the region's oil resources.

The importance to our country and our allies of a secure flow of Middle East and North African oil at sustainable prices is longstanding, has increased sharply in recent years, and will continue for the foreseeable future. I cannot overemphasize the need to restrain our own dependence upon this faraway resource, and it is significant that the OPEC producers of the region support the Administration's effort to make the United States less dependent upon their oil.

It is clearly in the interest of oil consumers to have good relations with producers. Our relations with the diversity of governments in the North African

and Middle Eastern oil states cover the spectrum from excellent to virtually nonexistent. The Western oil industry's loss of control to producer governments, the Arab oil embargo in 1973, and the pressures brought on world oil markets by the Iranian revolution leave no doubt that political factors can profoundly influence the availability of the region's oil and attitudes with which producing governments approach pricing and other energy issues. The quality of our overall relationships with producing governments, involving a range of political and security considerations, determine to a large extent the environment in which we seek their cooperation on energy questions. Relations among the oil producers, including the political dynamics in OPEC, also affect pricing and production decisions. Political considerations will remain an important determinant of the availability of the region's oil, as will, of course, the security of the region.

Increasingly, however, as the region's producers in the last decade have gained full control of their national oil policies, economic considerations have come to play a more complex role in price and production policies. A critical concern in this decade is that the demand for the region's oil is likely to keep pressing against the limits of the producers' willingness to provide it. The issue focuses on OPEC's leading producer, Saudi Arabia, and its gulf neighbors. The demand for their oil exceeds their demand for oil income. As a result, there are strong and intensifying pressures in these countries to conserve the principal source of national wealth.

These governments, however, have strong ties to and interests in both the industrial and the developing worlds. Hence the issue is joined on how narrowly or how broadly they define their economic interests as they make decisions on how to respond to market forces in their oil production and pricing policies.

A central task for our diplomacy in this decade will be to seek a stronger base of common economic purpose with these producers. The task involves a variety of issues:

- Conservation of energy in the United States and other industrial countries;
- Development of alternate energy resources in both the industrial and developing worlds;
- Control of inflation and stability of the dollar;
- The quest for greater international financial cooperation and more effective international economic development; and
- The transfer of technology.

Given reasonably propitious political and security environments for U.S. interests in the Middle East and North Africa, our success in dealing with these economic issues will increasingly help determine the quality of our relations with key producers, our own security and prosperity, and that of the world generally.

Political Factors

The political environment in each of the producer nations and their attitudes toward the United States and other industrial countries clearly have an impact on how each government approaches oil production and price decisions. Over the last quarter century, revolutionary regimes in the region—particularly new ones—have exhibited considerable hostility to Western oil interests, have tended to be confrontational rather than cooperative on economic issues, and generally have been "price hawks."

By contrast, Saudi Arabia and the three gulf emirates in OPEC have maintained close relationships with the United States and the United Kingdom, and our political relations with these monarchies have, except in periods of intense Arab-Israeli hostilities, generally been conducive to a cooperative approach in economic matters, including oil.

A variety of political influences, including a common attachment to preserving the strength of OPEC as a mechanism for setting a price floor, work on the producers as they formulate production and pricing policies and seek OPEC price decisions.

All of the region's producers are influenced by an attachment to Third World causes, although the breadth and degree of commitment varies. The Iraqis increasingly seek a leadership role in this regard and have gone further than other producers in pushing the idea of a two-tier price system for industrial and developing countries. Kuwait, Saudi Arabia, and Abu Dhabi are leaders in development lending.

Security considerations obviously lie at the heart of the politics and foreign policy of the producers. They produce complex and sometimes contradictory forces. All of the producers feel vulnerable to some degree to outside powers, to Middle East rivals, and to the tensions of domestic change.

This complexity prevents our drawing simple conclusions on how the gulf producers relate political and security concerns to their oil policy. Clearly, however, a strong U.S. global military posture, including an ability to project deterrent strength, is important to a long-term constructive relationship with producers. So is the perception that the United States is alert and firm in checking Soviet designs in the area and is dynamic in its role in a Western alliance with great interests in the Middle East and North Africa. The complexities and contradictions of the security situation and the basic fragility of the region require that the U.S. security role be played out with steadiness of purpose, nuance, and sensitivity to the political environment.

All of the Arab producers have indicated to some degree that in the longer term their attitudes on oil will be affected by their perception of how the international community deals with the Palestinian cause. Revolutionary rhetoric on punitive use of the "Arab oil weapon" is unabated. Among the monarchies there is a growing tendency to use a "carrot" approach, by suggesting more favorable consideration in oil supply in return for greater political support for the Palestinian cause. We cannot rule out that this trend will intensify over time if the Arab producers become increasingly disillusioned with the rate of progress toward Middle East peace. The recent trend toward state-to-state oil arrangements enhances the ability of the Middle East and North African producers to mix politics and oil and lessens the ability of the major oil companies to manage dislocations resulting from destination restrictions.

Political Dynamics of OPEC

Although economic considerations primarily determine producer policies, the impact of political factors on an organization such as OPEC, composed of nation states, is inevitable. Political relations among the diverse members of the organization play some role, as does the motivation to exert leadership within OPEC councils. Thus within the range of options which the market offers, OPEC as an organization is liable to political responses. The perception that consumer nations are banding together in confrontational posture to "break" the cartel tends to elicit a political and more confrontational response from OPEC. The perception that the industrial world is seeking to work with the OPEC countries to expand common economic interests tends to elicit a more cooperative OPEC response toward consumers.

Iran

In the context of this appearance I believe it is not necessary to lay out for the committee the recent state of our relations with Iran, on which there is an extensive public record. For the present the hostage situation prevents normal development of economic and other relations.

With regard to energy, Iran in the past was the one OPEC member that had both large oil reserves and production capacity and also a large appetite for revenues. The intent of the Islamic Republic to reshape Iran's economy toward less dependence on oil, combined with labor and technical difficulties in the oil fields, had resulted in much lower production even before Iran's attempt to charge exceptionally high prices brought its production to present low levels—currently about 1.5 mm b/d. Given the Iranians' recent willingness to forgo exports rather than reduce their high asking price, we must assume that Iran will continue to stress maximizing prices rather than seeking increased revenues through higher export volume.

Algeria

Our relations with Algeria were fully restored in November 1974 and have in general shown gradual improvement. Political differences on the Middle East peace process and on the Western Sahara have not prevented the development of a cooperative approach on bilateral matters involving mutual economic interests. Currently, however, we and certain European nations are involved in bilateral negotiations with Algeria over the price of Algerian liquefied natural gas. Shipments under the El Paso contract have been suspended pending resolution of this problem.

Our Embassy has had ready access to appropriate Algerian officials, but over the years we have had little influence on Algerian attitudes on oil pricing. Algeria, of course, has been a net borrower, whose development expenditures have regularly exceeded its income. It has maintained oil production at a high percentage of reserves and is currently attempting to increase exploration activity (e.g., through its $3 per barrel exploration fee), though on terms many companies find onerous.

Libya

Since the Libyan revolution, relations between the United States and Libya have been at best strained. In the aftermath of the attack on our Embassy in December of 1979 and allegations of a worldwide Libyan Government-sponsored intimidation campaign, relations are at a low ebb, and the U.S. Embassy in Tripoli remains temporarily closed. Nonetheless, the United States continues to emphasize the mutual benefits in our economic relations. The United States receives approximately 8% of its imported oil supply from Libya, and U.S. companies and personnel provide much of the vital expertise, manpower, and facilities for the production and distribution of Libyan oil. We have not been able to carry on a meaningful dialogue on energy issues with the Libyan Government.

In spite of its small population, Libya, though maintaining some financial reserves, has generally managed to spend the bulk of its considerable revenues on development, arms, and support for its foreign policy. It has consistently argued for keeping upward pressure on price through adjustment of production. Libya itself has used this method to some extent but has generally produced near its practicable capacity in recent years, desiring to maximize revenue through both volume and price. Even recent cutbacks appear influenced by technical factors, as new discoveries have lagged and reserves are declining.

Iraq

Iraq broke diplomatic relations with the United States during the 1967 Arab-Israeli war. Since 1972, when Interests Sections were opened in Baghdad and Washington, we have maintained sustained but limited contact with the Iraqi Government. Over the past several years, the United States has made known on a number of occasions its willingness to normalize relations. Although Iraq has not precluded this possibility sometime in the future, it has indicated it does not believe the present is the appropriate time. Thus the United States is limited in its ability to carry on an economic dialogue with Baghdad at present, but the U.S. private sector is playing an increasing role in Iraq's economic development.

With the sharp price increases of 1979–80, Iraq has become a new member of the surplus-revenue club. Iraq has carefully kept development spending within limits of absorptive capacity and is expected to continue to do so. Nevertheless, spending on development and arms has been high and until recently has not lagged far behind revenues. Since early 1979, however, Iraq's foreign exchange reserves have grown rapidly and are now believed to stand at well over $20 billion. Spending will continue to grow but not so rapidly as revenue unless the market permits Iraq to trim production without setting off further price increases. Iraq has generally produced near capacity and has plans to continue increasing capacity and exploring for new reserves. It is increasing bilateral assistance to developing countries, in part to further its desire for a leadership role in the nonaligned movement. Recently Iraq has taken a more moderate attitude toward prices.

Saudi Arabia

For over a third of a century, the United States has maintained a deep interest in the territorial integrity and security of Saudi Arabia and has worked to develop broad, strong ties with that country. This Administration has worked intensely to further this longstanding policy. Our relationship with Saudi Arabia has weathered periods of great tensions in U.S.-Arab relations and has progressed steadily. The contribution that we make to Saudi and regional security is one of the important elements in this relationship. The Saudis look to us to be a dependable supplier of military equipment and training to enhance the Kingdom's own defense capability, and they recognize the key importance of U.S. global power in maintaining a strategic balance which deters outside intervention in the region.

As Saudi wealth and influence have grown, we have increasingly worked closely with the Saudi Government in efforts to bolster other countries in Africa and Asia where our two governments perceive a common interest in security and orderly development and a need to help reduce regional tensions.

Another major element in our relationship has been the ability of the United States, as a power with influence in both Israel and the Arab world, to make a unique contribution in the long quest for a just, comprehensive, and durable peace in the Middle East. The Saudis have come to share our basic objectives in this regard. They have not supported the Camp David approach, and disagreement on how best to pursue the negotiations has caused some strain in our relations. Nevertheless, we remain in close consultation. The Saudis have continued to urge more rapid progress in the peace process, while we seek Saudi understanding of our negotiating effort and eventual Saudi support for it.

In recent years our economic ties with Saudi Arabia have expanded significantly. The U.S.-Saudi Joint Economic Commission has become an effective vehicle for the transfer of American technology to assist Saudi development, while our private sector continues to play a leading role in this regard. This year about 37% of our total exports to the Middle East and North

Africa are going to Saudi Arabia. As Saudi Arabia has become an international financial power, its role as investor and development lender has expanded tremendously as has the need for close consultations between our two governments on international financial and development issues.

In this Administration our sustained diplomatic exchanges on the wide range of issues of common interest with Saudi Arabia have been reinforced by a process of frequent presidential and Cabinet-level communications and contacts. Crown Prince Fahd's Washington visit in the spring of 1977, the President's visit to Saudi Arabia in January 1978, and King Khalid's visit to the White House in November 1978 have been highlights of a sustained exchange, which on the economic side has included exchanges of visits between the Secretaries of the Treasury, Secretaries of Energy, and the Under Secretary of State for Economic Affairs and their Saudi counterparts.

Saudi Arabia has, in recent years, maintained oil production at levels providing income well in excess of its domestic development needs. Since last summer Saudi Arabia has produced 9.5 mm b/d of oil (9.8 mm b/d counting its share of production from the partitioned zone between Saudi Arabia and Kuwait), a million barrels daily above its preferred production level.

Saudi oil reserves would permit expansion of sustainable production capacity significantly above present levels, but many Saudis question whether there is sufficient economic incentive to make the investment required to increase production. The Saudi Government has, in recent years, embarked on ambitious economic and social development programs. Much of the physical infrastructure of a modern society is now in place, and the absorptive limits of the economy have been revealed. Industrial prospects, except in the petrochemical area, are limited. There are strong social pressures for slower development, which in view of recent price increases suggests slower growth in expenditures and even more rapid accumulation of financial surpluses than in the past. Some Saudi officials argue that oil in the ground is a better investment than financial assets acquired with surplus revenue. It has become increasingly difficult for policymakers to justify, in terms of narrowly defined economic self-interest, continued production well in excess of domestic income requirements.

The growing conservationist trend in Saudi Arabia has been balanced by concern for the welfare of the international economy. In addition to its significant role as a lender to poorer countries, Saudi Arabia has an increasing stake in the international economy and financial system. There is no question that the government approaches oil production and price decisions with concern for the impact of its decisions on the stability of financial markets, the state of the dollar, and the impact on inflation and growth rates in the industrial countries—from which most of their imports come—and in developing countries. The importance Saudi Arabia attaches to these broader economic interests and concerns, involving the health of the international economy, is evidenced by the choices it has made in its own production and pricing policy and the role it has played in OPEC in working for a more orderly evolution of oil prices. Saudi Arabia's legitimate and continuing concern with balancing its narrower and broader economic interests will continue to play a central role in its choices on oil production and prices.

Gulf Emirates

The gulf states were important to U.S. economic interests and private American presence was significant there well before Kuwait achieved full independence in 1961 and before the independence of Qatar and the formation of the United Arab Emirates (U.A.E.) in 1971. In the era of full independence, it has been U.S. policy to develop close relations with these three states and their gulf neighbors and to pursue the expansion of mutual interests across a range of issues, while remaining in close consultations with the United Kingdom, which has long shared our basic interests in this region. Our general policy approach toward the gulf states, and the general course of our relationships, has been consistent with our longstanding and more developed relationship with Saudi Arabia, and we welcome and seek to encourage the commitment of Saudi Arabia and its gulf neighbors to close cooperation in the interest of the region's security and sound development.

The Iranian revolution and the intensified Soviet pressure against the region, manifested in the invasion of Afghanistan and the close Soviet relationship with South Yemen have, of course, prompted careful and sustained review of our policy toward the gulf states and of how we best can contribute to the region's security and progress. We seek to strengthen our relations with the gulf states across the economic, political, cultural, and security spectrums. We have increased U.S. naval presence in the Indian Ocean and are in the process of developing an improved capability to project deterrent force toward the region.

Over a number of years we have developed security assistance relationships with Kuwait and the other emirates and continue to make appropriate U.S. military equipment and training available to help these small states develop a reasonable defense capability. We remain in close diplomatic contact with them on a variety of political issues of importance to the region, particularly our quest for a comprehensive Middle East peace. Kuwait, Qatar, and the U.A.E. share our goal of a peaceful settlement although they do not support the Camp David approach.

On the economic side we maintain important commercial ties with Kuwait, the U.A.E., and Qatar and have supplemented, when requested, the substantial exchange of private sector technology with U.S. Government experts in areas of interest to these countries' development programs. We keep in close diplomatic contact on energy and economic issues, including the significant role these states play as constructive international investors and generous development lenders. In this Administration this dialogue has been supported by visits of former Secretary of the Treasury [W. Michael] Blumenthal, Secretary of the Treasury [G. William] Miller, and Under Secretary of State [Richard N.] Cooper to both Kuwait and the U.A.E.

The oil policies of these three states differ notably. Qatar is a relatively minor producer of oil (500,000–550,000 b/d). Although it has vast reserves of non-oil-associated natural gas, which it is now making plans to exploit, its oil reserves are limited, and production is expected to decline slightly over the decade. Qatar's production has tended to move up to capacity as the market tightens and to fall off slightly as the market eases.

The U.A.E.'s production and pricing policy involves essentially the same considerations as that of Saudi Arabia. On one hand there is concern for conserving its primary resource and avoiding too great a surplus in revenues and a broader concern, reflecting its stake in the international economy, for helping to maintain the health of that economy by contributing to orderly oil markets. The U.A.E. has generally supported Saudi positions on price restraint, although in recent months its price has been above the Saudi level. The U.A.E., too, has been a substantial lender and investor. The U.A.E. has also contributed to world energy supplies and domestic economic development through fostering exports of liquefied petroleum gas and liquefied natural gas.

Recent nuances in the oil policy of Kuwait may be a guide to future tendencies in other producing countries. Kuwait's new production level of 1.5 mm b/d (1.8 mm b/d counting its share of the partitioned zone) represents a long-heralded decision to cut back production in response to conservationist pressure, and hence this level may remain firm for some time to come. This level of production provides sufficient associated natural gas and natural gas liquids to supply Kuwait's liquefied petroleum gas plant at the desired level and to meet domestic needs. It also provides oil revenues more than sufficient to finance Kuwait's domestic development, welfare, and security needs; its foreign aid; and its extensive and sophisticated investment programs. If it maintains a fixed production policy, Kuwait will, in effect, have opted out of any ongoing efforts to influence prices through production policy. In the past Kuwait has at times asserted that oil policy is a "commercial" rather than "political" issue, and its new approach seems to reflect a more aggressive commercial thrust to marketing. Kuwait's oil policymakers reportedly are focusing attention downstream and overseas—on controlling the destinations of their crude and using access to their fixed supply as an instrument to gain access to promising investments abroad in exploration, refining, and petrochemicals.

Conclusion

The implications of the foregoing discussions are clear and unsurprising. The OPEC countries that desire greater revenues have little or no flexibility to raise production. Those that have this flexibility in production capacity, and sufficient reserves to expand capacity, currently receive a surfeit of oil revenues. Thus, as noted at the beginning of this statement, the issue focuses on OPEC's leading producer, Saudi Arabia, and its gulf neighbors: Kuwait, the U.A.E., and, increasingly, Iraq. These countries can easily support or raise oil prices by trimming production. They can ease upward price pressure by producing more, though their ability to restrain prices in this manner is limited, as the past year shows. In a tight market, they can increase their revenues by producing less oil, and as prices increase so do surplus revenues and pressures for lower production.

In the case of the three monarchical states, these facts, plus their concerns for and stake in the international economy, add up to conflicting economic interests. In each of them many argue that oil production should be reduced to maximize unit revenue and to stretch the life of their oil reserves, whose value, they believe, will increase more rapidly than the financial assets they can acquire with excess revenues. These groups also argue (a) that excessive revenues promote excessive and destabilizing development spending and (b) that restricting production and driving up the price of oil will force the developed countries to conserve energy and to accelerate the development of alternatives, thus reducing their extreme dependence on imported oil.

Opposing this narrow "conservationist" view is a broader conception: that over the long-term, the economic interests of these states are linked to those of the industrial and developing worlds and that they should, therefore, follow production and pricing policies that will sustain the international economy while facilitating an orderly transition to alternative energy sources.

This broader view also recognizes the relation between healthy economies and the ability of the industrial democracies to maintain a global strategic balance conducive to world peace and the security of the Middle East.

This economic debate, of course, takes place in a political context in which the dominant themes are Middle East peace and regional security. This context, in turn, influences our ability to engage in useful dialogue with these producers. But there are no simple tradeoffs between the economic and energy issues on one hand and political and security issues on the other. Only a lessening of our dependence on Persian Gulf oil, desired by both consumers and surplus-revenue producers, will in time resolve the economic and energy issues. But such factors as significant progress toward a just and comprehensive peace and U.S. ability to accommodate regional security concerns can greatly affect our ability to make ourselves heard.

Our energy diplomacy with respect to these states aims at strengthening the broader, more cooperative view of their own interests. This purpose is served by our cooperation in their efforts to develop and strengthen their own societies and by their increasing involvement in the international economy.

The pace of economic development in, and transfer of technology to, these countries will be a factor in determining their domestic income requirements. An important element, for example, will be the extent to which countries, such as Saudi Arabia, are able to develop viable oil-related industries which might serve as an inducement to higher crude oil production levels. The continuing willingness of surplus-revenue producers to commit substantial amounts of their oil income to foreign aid will also be an important factor, and the ability of the industrial nations to draw them more closely into the development assistance community will influence this. Perhaps more critical will be the perception of the surplus producers of the benefits or lack thereof of investment of their surplus earnings in the industrial world. This involves not only questions of freedom and security of investment but also the issues of inflation, stability of financial markets, and particularly the strength of the dollar.

In the perception of Saudi Arabia, Kuwait, and Abu Dhabi, a stable market for Middle East oil in the industrial world is preferable to ever-increasing demand. They fear that future gaps between supply and demand can lead to dangerous international tensions. The heart of this way of looking at things is that consumers' excessive dependence on Persian Gulf oil endangers both sides. In this situation the producer's responsibility is to make possible a reasonably smooth transition to less dependence; the consumer's is to achieve that transition as quickly as possible. ■

Published by the United States Department of State • Bureau of Public Affairs • Office of Public Communication • Editorial Division • Washington, D.C. • August 1980 • Editor: Colleen Sussman •

Bureau of Public Affairs
United States Department of State
Washington, D.C. 20520

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